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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

ARIZONA GOVERNING COMMITTEE FOR TAX DEFERRED ANNUITY AND DEFERRED COMPENSATION PLANS, STATE OF ARIZONA, et al.,

Petitioners,

v.

NATHALIE NORRIS, on behalf of herself and all others similarly situated,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

AMICUS CURIAE BRIEF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED FOR REVIEW

1. Whether 42 U.S.C. § 2000e-2(a)(1)(1976) applies to the Arizona voluntary deferred compensation plan so far as it provides an option to participants to elect a life annuity provided by insurance companies using sex-segregated mortality tables.

2. Whether the order of the Court below, though not directed to any insurance companies, constitutes the regulation of insurance contrary to 15 U.S.C. § 1012(b)(1976) which thus precludes that Court from thus indirectly forcing the use of unisex tables on insurance companies or otherwise disrupting their markets.

3. Whether actuarially equivalent annuities are equal so they do not discriminate against any individual on the ground of sex contrary to 42 U.S.C. § 2000e-2(a)(1)(1976).

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STATEMENT OF INTEREST

The National Association of Insurance Commissioners (NAIC) is an unincorporated association. Its members are the principal regulatory officials charged by state laws with the supervision of the business of insurance within the United States. By consent of both Petitioners and Respondents, the NAIC files this brief as amicus curiae.

The state insurance commissioners and the public they protect have a vital interest in the outcome of this litigation. Jurisdiction to regulate insurance has been allocated to the states by the McCarran-Ferguson Act, 15 U.S.C. § 1011-15 (1976). Any decision that affects jurisdiction to regulate is of great interest to the commissioners, for it has potentially important impact on the performance of their regulatory tasks and significant consequences for the insurance industry they regulate and the public state insurance regulation exists to protect.

Affirmance of the decision below in this case would put important constraints on the market for annuities and insurance and would necessitate an important revision in the pattern of state regulation of the mortality tables, rates and benefits relevant to such insurance products. For that reason, the NAIC believes it may be of help to this Court to have a view of the case from the perspective of the state insurance regulators.

STATEMENT OF THE CASE

The NAIC accepts the statement of the case made by the Petitioners.

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SUMMARY OF THE ARGUMENT

In the case at bar, the decision below was that it violated 42 U.S.C. § 2000e(a)(1)(1976) for Arizona to provide life annuities offered by insurers using sex-segregated mortality tables as an option in a supplementary deferred compensation plan. The state expected to make no contributions to the plan.

Relying on *City of Los Angeles, Department of Water and Power* v. *Manhart*, 435 U.S. 702 (1978), those courts thought

that because women would receive smaller periodic annuity payments under the life annuity option the plan discriminated against women, though all other options were sex neutral. Arizona would have to make up the deficits.

Arizona then withdrew that option to avoid having to supplement the annuity payments to women. Arizona's actions clearly indicate what employers will do if *Manhart* is interpreted to require them to contribute additional funds to women's retirement benefits. The same thing will happen in basic annuity plans to which employers contribute. That will disrupt the market, contrary to this Court's expressed intention in *Manhart*. If insurers seek to avoid that disruption by adopting unisex tables, male participants will tend to withdraw from the life annuity option.

The legislative history shows that Congress can not have thought much about the consequences of adding "sex" to the prohibition. It is not believable that Congress would have adopted the amendment if its members had had any idea that the courts would interpret it to have such disruptive effect.

Further, Congress in the McCarran-Ferguson Act, 15 U.S.C. § 1012(b)(1976), allocated regulatory power over insurance to the states, except where Congress specifically indicates otherwise. It did not so indicate in the statutes relied on here. The order of the Court below did not address insurance companies directly, but realistically the order significantly governs and disrupts the insurance business. The Act so interpreted is the regulation of insurance in a way inconsistent with the McCarran-Ferguson Act.

The states, including state insurance departments, are not insulated by McCarran-Ferguson from changes in our society. They have long been as much concerned about unfair discrimination, including unfair sex discrimination, as federal agencies. In some areas insurance department concern long antedated federal involvement. In insurance state concern is also more continuous and pervasive.

While insurance departments have concluded that sex, properly used in accordance with sound actuarial practice, is an appropriate classifier for some kinds of insurance, its *unfair* use has been frequently addressed by state insurance departments and will continue to be investigated. Because insurance commissioners have greater expertise in insurance and a more constant and pervasive presence there than any other agency, the best locus for regulation of unfair discrimination in insurance pricing is in the state insurance departments.

The decisions in the courts below should be reversed and the complaint of Nathalie Norris et al. dismissed.

ARGUMENT

I. THE ULTIMATE CONSEQUENCE OF AFFIRMANCE OF THE CIRCUIT COURT OF APPEALS DECISION IN *NORRIS* V. *ARIZONA GOVERNING COMMITTEE* IS LIKELY TO BE THE SUBSTANTIAL DISRUPTION OF THE MARKET FOR INSURED LIFE ANNUITIES.

Careful planning for old age requires that a person insure against the risk of living too long, i.e., against the consequences of outliving both one's capacity to earn and one's savings. The only adequate way for most people to solve this serious problem is to purchase, with at least some portion of savings and in many cases all or substantially all of them, an insured life annuity in which the insurance company assumes the risk of the extension of life beyond the capacity to earn a living and after savings would have been exhausted in the absence of an annuity. If savings were consumed in the absence of an annuity, on the assumption that life would continue only approximately as long as one's life expectancy, savings would be exhausted a considerable time before death in a significant percentage of instances.

A life annuity is the converse of life insurance. The protection afforded by it is even more important at the end of life than is life insurance in the younger years, except for people who have accumulated considerable wealth.

The consequence of the District Court decision in *Norris* v. *Arizona Governing Committee,* as affirmed by the Court of Appeals for the Ninth Circuit, was entirely predictable. Arizona already had a separate contributory retirement program to which it had allocated that portion of its budget it thought appropriate to devote to aiding employees create a retirement program. The plan involved in this case was a supplementary voluntary deferred compensation plan devised to assist employees who wished to take advantage of provisions of the Internal Revenue Code permitting tax-deferred saving for retirement by a deduction from salary. Because it was a voluntary program planned as an accom-

modation to employees, the state did not intend to make a contribution to it and did not budget for such a contribution. There was nothing improper in Arizona both facilitating the tax deferred saving by employees and declining to contribute further state resources to encourage the saving. Nevertheless, the defendants were enjoined "from carrying out their obligations under Ariz. Rev. Stat. Ann. § 38-871 *et seq.*, through the use of sex-segregated tables and directing that future annuity payments to female employees who have retired shall be equal to similarly situated male employees." *Norris v. Arizona Governing Committee*, 671 F.2d 330, 335 (1982). The state must make up the difference on the monthly payments of those women employees who have retired. Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, p. 5. Faced with the prospect of such additional contributions to retirement programs of women retiring thereafter, Arizona terminated the life annuity option for the future, so that the plan created for the accommodation of employees would not increase the state's operating costs. This action deprived all the state's 35,000 employees who were not yet retired, both men and women, of the important life annuity option. *Id.*

Termination of the life annuity option left two options open to participants: a lump sum withdrawal of accumulated funds at the point of retirement and an annuity for a term of years. The exercise of the option of a lump sum withdrawal of accumulated savings may have the adverse tax consequence of requiring payment of tax on the entire amount at that time. Further, if the participant goes into the open market with the lump sum to buy a life annuity, he or she does so as an individual buyer, usually with little knowledge of this technical market and without the advantage of mass purchasing power the state had which might have resulted in substantial savings in the expense portion of the annuity consideration.

Electing the second option, an annuity for a term of years, may reduce the transaction costs substantially but it fails to provide the requisite protection against excessive length of

life. A substantial fraction of the participants will, under that option, receive larger annuities in the early years but will be left with sharply reduced income during the last years of life.

There is no reason to doubt that what has happened in this voluntary deferred compensation plan will happen in a large proportion of all such plans, which are very common whenever the advantage of tax deferral is available. More important, it will also happen with many if not most basic retirement programs to which employers contribute. Because the Equal Pay Act forbids employers to eliminate unlawful discrimination in compensation by reducing the contributions on behalf of men to keep total contributions the same, 29 U.S.C. § 206(d)(1) (proviso), many current programs are such that this case if affirmed would require additional employer contributions to equalize the periodic annuities paid to men and women.

Thus, if one of the available options under any existing plan is a life annuity offered through an insurance company that uses sex-segregated mortality tables, *Norris* v. *Arizona Governing Committee,* if affirmed, together with the Equal Pay Act would require the employer to make additional contributions to equalize the periodic annuity payments as between men and women under that life annuity. No one can doubt, therefore, that the ultimate consequence would be to create substantial employer uncertainties and induce many employer withdrawals from life annuity options in any plans subjecting or having the possibility of subjecting the employers to the requirement of making such additional contributions. Such withdrawals would destroy a significant part of the market for life annuities and would be a revolutionary change in the pension and insurance industries, for insured life annuities would cease to be available to a large share of the potential market. The insurance solution to the old age problem would immediately be much less readily available to protect people against one of the serious problems of old age, that of outliving one's sources of income.

II. IF INSURANCE COMPANIES TRY TO RESPOND TO THREATENED WITHDRAWAL OF EMPLOYERS FROM THE LIFE ANNUITY MARKET BY SHIFTING TO UNISEX MORTALITY TABLES, EXTENSIVE MALE EMPLOYEE WITHDRAWAL FROM THE LIFE ANNUITY MARKET IS THE LIKELY CONSEQUENCE.

Faced with the threatened loss of a significant portion of their share of the retirement income market because of natural employer reluctance to increase contributions to retirement in order to supplement female annuity payments, some insurance companies may consider responding by changing from sex-segregated to unisex mortality tables. Such changes have already been contemplated by some companies. Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit, p. 7.

If a contributory retirement plan gave the employee only a single option, the purchase of a life annuity from an insurer using a unisex mortality table, male employees would not be able practicably to withdraw from the retirement program for that would mean forfeiting the employer's contribution. This scheme would also seem to satisfy the demands of the law as interpreted in the Court of Appeals decision in *Norris* v. *Arizona Governing Committee*. Before affirming that decision, however, the Supreme Court might wish to contemplate the long-range consequences.

Male employees would gain from the decision a strong incentive to put all the pressure they can on employers to provide such other options as Arizona provided in this case: lump sum withdrawals of contributions on retirement and annuities for a term of years. The effort should often succeed. Annuities for terms of years would appear especially advantageous to men; actuarially such annuities would be worth appreciably more to men than life annuities based on a unisex table and would appear to be even more attractive than they really are for periodic payments would be larger than for life annuities and the tax "bite" might not be much

different. Such annuities could not be attacked as discriminatory under Title VII.

With increasing sophistication of the working population, particularly of that portion of it protected by substantial retirement plans, there would be a considerable incentive for male employees to rely for protection against too long life on Social Security alone, while putting most of their retirement savings into forms that do not provide insured protection against excessive length of life. That is, the natural consequence of a shift to unisex tables is ultimately to remove large numbers of male employees from the life annuity market and put them into the market for annuities for a term of years, thus revolutionizing the insurance and pension industries and drastically reducing the role life annuities would otherwise play. A shift to unisex tables would thus not prevent the serious disruption of the market for life annuities. The cost of such annuities to women would then rise as men withdrew, eventually approximating the present cost under sex-segregated tables. There is no reason to doubt that men would select among the available options those appearing to be most advantageous to them.

No one can predict the exact dimensions of the changes that would occur, but no one can doubt their direction. While not every human decision is an economically rational one, a large percentage are. The TIAA response to the uncertainties in the law and the pressures from some universities was to propose to change to a unisex table, to preserve the TIAA market. *Id.* Even if that change finally takes place, it is only the first act of the play.

The second act is increased pressure by male employees on employers to expand the options available to them. That pressure is now already beginning to occur in some universities for other reasons; the pressure could only increase. The Arizona response was predictable and its ultimate consequence clear—all state employees were deprived of the valuable life annuity option for the application of supplemental retirement savings. Similar undesired consequences would

follow if insurers should change to a unisex table. If employers are denied the freedom to use the free market, inefficiency results, distribution costs rise, women lose in added costs of a less efficient insurance system more than they gain from the unisex tables and everyone will be worse off than before, women as well as men.

III. IT IS NOT CREDIBLE THAT CONGRESS INTENDED IN TITLE VII TO IMPOSE CONSTRAINTS ON INSURANCE AND PENSION PROGRAMS THAT WOULD HAVE SUCH POTENTIALLY DRAMATIC AND UNSETTLING IF NOT DISASTROUS CONSEQUENCES, REVOLUTIONIZING THE INSURANCE AND PENSION INDUSTRIES.

This Court said in *Manhart* that it did not suggest "that the statute was intended to revolutionize the insurance and pension industries." *City of Los Angeles, Department of Water and Power* v. *Manhart*, 435 U.S. 702, 717 (1978). As *Manhart* is interpreted by the Court of Appeals for the Ninth Circuit in *Norris* v. *Arizona Governing Committee*, such an effect of Title VII on those industries is more than possible; it is probable. Is it believable that Congress would have enacted a provision with the intent to bring about such momentous changes?

The central question for consideration is whether section 703(a)(1) of the Civil Rights Act of 1964, as amended, was intended to invalidate the Arizona voluntary deferred compensation plan so far as it provided for life annuities through insurers using sex-segregated annuity tables. That section states that it is "an unlawful employment practice for an employer . . . to discriminate against any individual with respect to his compensation, terms, conditions or privileges of employment, because of such individual's race, color, religion, sex or national origin." 42 U.S.C. § 2000e-2(a)(1)(1976).

The word "sex" was not in the original bill. The addition of "sex" to the bill as a prohibited basis for discrimination in employment came in a floor amendment, and was not preceded by any studies, legislative hearings, or public dis-

cussion. It was proposed by a Congressman who voted against the Act and who, it has been suggested, introduced the amendment as a strategy for cluttering up the Act so it would have no chance of passage. Bernstein & Williams, Title VII and the Problem of Sex Classifications in Pension Programs, 74 Colum. L. Rev. 1203, 1216-17 (1974). See 110 Cong. Rec. 2581 (1964) (remarks of Congresswoman Green).

The discussion on the floor of the House was extensive, but it was mostly high-flown rhetoric. *Id.* pp. 2577-2584. It began on a note of levity but then became a bit more serious. It did not address the question what Congress actually thought it was doing by adding "sex" to the bill. In her speech opposing the amendment, Congresswoman Green of Oregon emphasized that the main purpose of the bill was to help blacks, who had been discriminated against far more than women. She did not want to risk the bill by virtue of the amendment. She emphasized that there was not a word of testimony on the subject and no petition by any women's organization asking for the amendment. She even read a letter from the American Association of University Women opposing it. (Another women's organization supported the amendment). The writers of the AAUW letter considered the amendment redundant and to the disadvantage of the legislation. Congressman Roosevelt pointed out that his mother had chaired the President's Commission on Opportunities for Women. He pointed to the complexities of the problems of providing equality in employment for women and said that when a report was forthcoming and a recommendation had been made, the House would try to find a way to eliminate discrimination against women without the harm that might result from legislating unwisely.

From the welter of words nothing emerges to give a clue to the intended meaning of an amendment that was introduced for unknown reasons, that was not preceded by the study one would expect of an important change in the law that might produce the dramatic alteration in complex relationships

urged by the plaintiffs in this case. It passed by the fairly even vote of 168 to 133. *Id.*, 2584.

In short, there is no basis in the legislative record for even guessing what Congress, or individual Congressmen or Congresswomen intended to do by adding the word, if they voted for its addition. Of course the amendment was meant to do something, but just what is not clear. At least it was surely not intended to work the radical changes for which various people including plaintiffs now seek to use it.

Trying to solve one problem of alleged illegal sex discrimination under the Act, the Court of Appeal for the Fifth Circuit, speaking through Simpson, J., said in *Willingham* v. *Macon Telegraph Publishing Co.*:

> We find the legislative history inconclusive at best and draw but one conclusion, and that by way of negative inference. Without more extensive consideration, Congress in all probability did not intend for its proscription of sexual discrimination to have significant and sweeping implications. We should not therefore extend the coverage of the Act to situations of questionable application without some stronger Congressional mandate. 507 F.2d 1084, 1090 (1975).

In *Manhart* this Court decided that the provision invalidated a retirement plan under which larger sums (by a factor of 14.84%) were deducted from the salaries of women than of otherwise comparable men, thus reducing the take-home pay of women more than that of men by that factor. But this Court confirmed the wisdom of the restraint in *Willingham* by saying in the key paragraph in Justice Stevens's majority opinion:

> Although we conclude that the Department's practice violated Title VII, we do not suggest that the statute was intended to revolutionize the insurance and pension industries. *All that is at issue today is a requirement that men and women make unequal contributions to an employer-operated pension fund.* Noth-

> ing in our holding implies that it would be unlawful for an employer to set aside equal retirement contributions for each employee and let each retiree purchase the largest benefit which his or her accumulated contributions could command in the open market. Nor does it call into question the insurance industry practice of considering the composition of an employer's work force in determining the probable cost of a retirement or death benefit plan. Finally, we recognize that in a case of this kind it may be necessary to take special care in fashioning appropriate relief (emphasis added). 435 U.S. 702, 717-18 (1978).

To enlarge the meaning of this Court's cautious language in *Manhart* into a sweeping condemnation of long accepted actuarial classifications in the insurance and pension business must rest on an implicit assumption that Congress gave the kind of careful thought to this matter that the legislative record patently shows it did not give.

It is simply not believable that the Congress can have intended the drastic consequences that would flow from affirmance of the Court of Appeals decision in *Norris* v. *Arizona Governing Committee*. For Congress to act in a way that would make it more difficult for the institutions of the private sector to provide protection against poverty in extreme old age is not credible, in the absence of careful and deep-probing study, committee analysis, and public hearings.

Yet, despite the casual way unfair sex discrimination was introduced into the Civil Rights Law, it is obvious that Congress did launch a first preliminary attack on a real problem, expressing in general terms an emerging public policy to which most contemporary Americans subscribe. Such legislative activity, however preliminary it may have been, is consonant with prevailing contemporary attitudes. Those attitudes, however, are reflected quite as much in what is happening in state legislatures and regulatory agencies as at the national level. It is not without irony in this connection that a third of the states have equal rights amendments

in their constitutions while the United States does not. It is relevant, therefore, to look at the Congressional determination about the allocation of power in the federal system in dealing with insurance. Even though the national agencies and those of the states are subject to similar pressures, derived from changes in public attitudes and interests, the exact parameters of any solution that may be adopted and the manner of implementing it will be different depending on how power to deal with an area is allocated.

IV. CONGRESS HAS ALLOCATED TO THE STATES THE PRIMARY RESPONSIBILITY TO DETERMINE THE PARAMETERS OF PUBLIC POLICY WITH RESPECT TO INSURANCE AND THE MANNER OF IMPLEMENTING THAT POLICY.

In the McCarran-Ferguson Act, Congress provided decades ago, after serious and deliberate consideration, that

> [no] Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance. . . . 15 U.S.C. § 1012(b)(1976).

There is no mention of the business of insurance in either the Equal Pay Act or in Title VII. While one may be able to argue plausibly that the pension scheme in *Manhart,* which was administered solely by the public agency, and even the voluntary contribution by employees in the present case, are not a part of the "business of insurance," no one can assert that the use of actuarial tables by insurance companies to determine annuities is not within the business of insurance. Further, it is a part of the business of insurance that is everywhere regulated—intensively—by the states. The McCarran-Ferguson Act provision will not, of course, preclude Congress from legislating with respect to the business of insurance but by virtue of its own firm decision it must do so explicitly. It has not done so.

The technical and complex character of insurance underlies the Congressional decision. When the McCarran-Ferguson Act was enacted, the only locus of government expertise in insurance was in state insurance departments. Furthermore, the state insurance departments provided then and provide now an enduring presence in the insurance field, which is lacking in Washington. Not unnaturally it seemed then to make sense to leave insurance regulation where it was and to do so by a firm declaration on the matter. Nothing has happened since then to justify altering that decision. Deciding exactly what should be the bounds of public policy and how it should be implemented in this complex field remains and should remain with the agencies having the greatest expertise and the most enduring involvement in insurance. Those agencies are the state insurance departments.

A not unnatural but fallacious reaction to assertion of the exemption of the business of insurance from the application of Title VII of the Civil Rights Act is to ask why the insurance industry, almost alone among economic institutions in our society, should be immune from implementation of contemporary public policy with respect to human rights. But this is a completely erroneous conception of what Congress did in both Title VII and in the McCarran-Ferguson Act, and it would lead mistakenly to a narrow, even distorted, interpretation of the McCarran-Ferguson Act exemption. In Title VII Congress dealt only with employment relations. In McCarran-Ferguson, Congress was not seeking to immunize insurance from developing views of public policy. It wished to do something quite different. The Act primarily determined that the parameters of public policy and the manner of its implementation would in the insurance field be determined by the states and not by the Congress. The insurance industry was exempted from nothing substantive and subjected to nothing substantive by the Act; it was instead made subject to a different maker and enforcer of the substantive rules. State jurisdiction does not create an immune island for insurance free from the ele-

mental forces operating elsewhere in our society. It only changes the identity of the arbiter.

The McCarran-Ferguson Act is not concerned with substantive rules but with the allocation of power in a federal system. The substantive rules may be the same as they would be under a regime of federal regulation, or entirely different, or partly the same and partly different.

Congress, having given the power to the states to determine and enforce the substantive rules, can take it away again. In recent years there have been numerous proposals in Congress to do just that. The proposals have been based, often, on simplistic and sometimes self-interested evaluation of state insurance regulation as ineffective, a conclusion easy to reach when state regulation is judged against an ideal standard but not so easy to reach when it is measured against the actual performance of other comparable agencies, state and federal, in the real world. Under the latter test state insurance regulation comes out reasonably well.

So far none of the proposals have prevailed or even come close to prevailing. But whatever future decisions are made, Congress declared quite clearly in the McCarran-Ferguson Act that its allocation of power may only be altered by specific attention to the matter in Congressional enactments. There has been no such specific attention to the matter in the Civil Rights Act or the Equal Pay Act.

To further establish that Congress was allocating governmental power and not exempting the insurance industry from conforming to accepted public policy, it is accurate to state that the same concerns about human rights that have exercised Congress in recent years have during the same period been considered and often implemented at the state level, both in insurance and in other aspects of the society. Indeed, state insurance regulation is one of the oldest of the systems of regulation in our society having a mandate to protect the public—the consumer. The mandate dates back to the mid-nineteenth century.

V. THOUGH THE SPECIFIC RESULT OF THE DECISION OF THE COURT OF APPEALS FOR THE NINTH CIRCUIT IN *NORRIS* V. *ARIZONA GOVERNING COMMITTEE* DOES NOT HAVE *DIRECT* IMPACT ON THE INSURANCE BUSINESS, IT HAS IMMEDIATE AND DRASTIC IMPACT. IT IS REALISTICALLY THE REGULATION OF INSURANCE.

Before the Court of Appeals for the Ninth Circuit, both appellant Arizona and amicus American Council of Life Insurance argued in this case that the McCarran-Ferguson Act precluded the Court from applying title VII, because the use of sex-based mortality tables was the "business of insurance" and Arizona had separately regulated the business of insurance. The Court of Appeals for the Ninth Circuit thought that argument fallacious, because the Court's order did not address any insurance company.

> The court has not said that the companies may not use sex-segregated annuity tables. Nor has it joined the companies as defendants or required the companies to pay the adjusted annuities. All the court has done is tell the employer that it may not offer a fringe benefit which treats an individual woman differently than an individual man. 671 F.2d 330, 333 (9th Cir. 1982).

This contention sounds plausible on paper but in the real world it is unrealistic. Except in degree the order is no different from an order to the universe of potential employer buyers of insured life annuities forbidding all such buyers to make any purchases from certain insurance companies. That order, though not addressed to insurance companies, would wipe out their market. Though there is no such sweeping order in this case, nor *any* order addressed to the insurance companies, they have effectively been outlawed and their market for group life annuities substantially destroyed. Though in the present case, the effect is less than total and only a share—but a significant one—of their market has been destroyed by the Court's order, the share is likely eventually to be a share so large as to make the rest unviable.

On demand by appropriate plaintiffs, orders would issue to any employer situated similarly to Arizona to refrain from dealing with any insurance company that used sex-segregated annuity tables. While in form that is an order to employers, in result it is an order to insurance companies to change their long-standing practices at penalty of losing their markets. It is the regulation of insurance, not directly but with drastic and immediate impact. If such an order purports to be based on Title VII or the Equal Pay Act, it is imperative that it first be found that Congress worded one or the other of those acts so that it would "specifically relate" to the business of insurance. Neither has any such wording. The Court order gives Title VII the effect of federal regulation of insurance, displacing state regulation contrary to the policy of the McCarran-Ferguson Act.

VI. THE STATES AS WELL AS THE FEDERAL GOVERNMENT HAVE BEEN CONCERNED IN RECENT YEARS WITH THE DEFINITION AND ENFORCEMENT OF HUMAN RIGHTS, BOTH GENERALLY AND IN THE INSURANCE FIELD.

Wide ranging state legislative activity to eliminate sex discrimination, all the way from "correcting" the relatively innocuous male-oriented language of the statute book to the most important of substantive issues within the jurisdiction of the states involving invidious and hurtful discrimination, is well known. It has now been under way for years in most states. State activity to define and enforce rules against unfair discrimination in the field of insurance are less well known because more technical, though equally important. To give some sense of that activity will make it clear that the McCarran-Ferguson Act does not isolate insurance companies from contemporary developments in standards of business morality. State concern has been broad-based, and has dealt with unfair discrimination wherever it has been perceived to exist, not just with sex discrimination. As at the federal level, the degree of success has varied from problem to problem. In addition it has varied somewhat from state to

state. On the whole, however, the states have probably been as successful as the federal government in creating and enforcing new standards of nondiscriminatory conduct. They have solved some problems; others remain to be solved. The important point here, however, is that state jurisdiction does not create an island immune to accepted standards of morality.

In the years that there has been activity and some achievement respecting human rights at the federal level, there has been continuous activity within the insurance regulatory fraternity at the state level. There has been extensive consideration of the use of sex, race, marital status, age, physical and mental disabilities, geographical location, and numerous other variables in rate-making and in underwriting rules in life, annuities, disability, automobile and other forms of insurance. Throughout the United States regulators at the state level have addressed these questions. The consideration has been extensive, sometimes deep-probing, and continuous in the sense that all these problems are under examination all of the time in various parts of the country. The results of the inquiries have not been uniform, for the problems are complex and thoughtful people do not always reach identical results on the corrections to be made in our laws and practices. But there has been no vacuum; the problem of fairness in underwriting and in rating has been much discussed in the state regulation of insurance.

It is inherent in the allocation of power and responsibility to regulate insurance to the states that there will not be national uniformity, for that is inconsistent with the very notion of wide distribution of power in a decentralized and democratic governmental system.

New York has typical statutes enacting into law basic principles of equity in pricing. Dating back to 1939 one has been in essentially the following language:

> No life insurance company doing business in this state . . . shall make or permit any unfair dis-

> crimination between individuals of the same class and of equal expectation of life, in the amount or payment or return of premiums, or rates charged by it for policies of life insurance or annuity contracts, or in the dividends or other benefits payable thereon, or in any of the terms and conditions thereof. . . . McKinney's Consol. Laws of N.Y. Ann., Ins. Law § 209.

Not every state has a statute as venerable, but similar statutes exist throughout the country.

Though it is without direct power, the National Association of Insurance Commissioners has long been both a forum and a vehicle for much of the development. For example, the NAIC has a long-standing Model Unfair Trade Practices Act that serves as a point of departure for discussion of problems of unfair pricing and other unfair marketing activity. (It has been widely, almost universally, adopted by the states in similar form and language). One section of that model act, like the New York Act, prohibits "any unfair discrimination between individuals of the same class and equal expectation of life in . . . any contract of life insurance or of life annuity. . . ." The model does the same thing for health insurance. NAIC Proceedings—1979 Vol. II, p. 262. (The model goes back some decades. The 1979 reference only gives the current formulation).

On the basis of the model act, the NAIC has developed model regulations which have been extensively adopted by the states. A model regulation to prohibit unfair discrimination on the basis of blindness or partial blindness, as adopted in 1978, *id.* 1978 Vol. II, pp. 273-74, 268, 266, led later to adoption of a more general model regulation to prohibit the practice of

> Refusing to insure, or refusing to continue to insure, or limiting the amount, extent or kind of coverage available to an individual, or charging a different rate for the same coverage solely because of a physical or mental impairment, except where

> the refusal, limitation or rate differential is based on sound actuarial principles or is related to actual or reasonably anticipated experience. *Id.,* 1979 Vol. II, pp. 262, 258, 252, 34, 31.

Commitment to "sound actuarial principles," i.e., to charging insureds as accurately as possible for the risk they transfer to the insurance system, is uniformly characteristic of rules proposed by state insurance regulators. The principle was stated by state insurance department actuaries in a recent report as follows:

> If there is to be a viable insurance sytem in this country, it must have a risk classification system that protects the insurance system's financial soundness; that is fair to insurance buyers; and that permits economic incentive to serve the broadest possible market.
>
> It is generally the position of the actuarial profession that insured individuals are treated equally if they are charged prices which equitable (sic) reflect the value of the risks they transfer to the insurance pool—not simply as a matter of theoretical preference but as a necessary condition to the sound operation of insurance programs. Determining the value of the risks transferred necessarily involves the use of averages and classification variables; therefore, the use of averages and class groupings is fundamental to insurance. Consideration of what is fair or unfair in insurance must take place within that conceptual framework. *Id.,* 1982 Vol. I, p. 392.

The statement was contained in a brief report entitled "Review of Sex Distinct Pricing in Individually Marketed Insurance." *Id.,* p. 391. Sex distinctions in pricing and in underwriting practices have been the subject of repeated discussion in the National Association of Insurance Commissioners and a great many states for a number of years. So also have marital status and other variables that have come under suspicion as not having sufficient reliability and there-

fore as constituting unfair discrimination. The inquiry is a continuous one.

One California rule-making decision will suffice to illustrate the activity. Proposed regulations relating to unfairly discriminatory practices based on sex or marital status received a hearing by an extremely able woman hearing officer whose recommendations were then adopted by the Commissioner. She heard testimony from the general public, from various interest groups, especially those representing women, and from the insurance industry. She examined records of similar hearings in New York, Pennsylvania, Michigan, Colorado, Iowa and a report from a California Commission. She considered it all thoughtfully and carefully and recommended adoption of rules that sought to particularize objectionable practices and to eliminate them when they constituted unfair discrimination on account of sex or marital status. The recommendation was in the highest tradition of enlightened public service and became part of the regulatory law and practice of our most populous state. See Ruling No. 204, File No. RH-176, Proposed Decision of Hearing Officer Angele Khachadour, November 19, 1975, and the Decision of Commissioner Wesley J. Kinder based thereon, November 20, 1975.

Various views have existed in state regulatory circles about sex-segregated pricing, as with interested Americans generally. In the late 1970's there was a surge of support in the states for the elimination of sex as a classifier but more extensive study seems to have led to general though not necessarily universal acceptance of the view that is stated in the above actuaries' report. The position is that private insurance needs to be cost-based to be viable, and that classification schemes that do not produce cost-based prices compel cross-subsidies that lead to withdrawal from the system of those providing the subsidies, if they are free to leave. Those who benefit from the subsidies stay as long as the subsidies last, driving the cost up. Cost-based pricing depends on the selection of criteria for pricing that have the greatest predic-

tive value among those about which reliable information can be gathered cost-effectively. Actuaries are in general agreement that sex is such a criterion for several classes of insurance, including both life insurance and annuities.

The National Association of Insurance Commissioners is not speaking defensively when it asserts the primacy of state regulation with respect to unfair price discrimination. The assertion does not concede that the insurance regulatory authorities of the states seek to insulate the insurance industry from modern conceptions of business morality. On the contrary, the assertion is that the problem is complex, that the state insurance regulators are as interested in its solution as anyone else, that they are more expert in insurance than others and are continually present, and that assignment of the task to them is both appropriate and wise. It is as likely to lead to proper solutions as the unwarranted assumption of power and responsibility by certain federal agencies. See Kimball, *Reverse Sex Discrimination: Manhart,* 1979 American Bar Foundation Res. J. 83.

VII. TWO PROMISES MADE TO TWO DIFFERENT PEOPLE THAT PAYMENTS WILL BE MADE TO THEM FOR THE DURATION OF THEIR LIVES ARE EQUAL IN VALUE IF AND ONLY IF THEY ARE ACTUARIALLY EQUIVALENT.

The District Court concluded in this case that the

> administration of the Deferred Compensation Plan of the State of Arizona, which provides or permits smaller monthly annuity payments to a female employee than to a male employee contributing the same amount, is discriminatory and in violation of Title VII of the 1964 Civil Rights Act. *Norris* v. *Arizona Governing Committee,* 486 F. Supp 645, 652 (Ariz. 1980).

The conclusion is erroneous.

Title VII forbids discrimination "against any individual with respect to his compensation, terms, conditions, or

privileges of employment, because of such individual's . . . sex." 42 U.S.C. § 2000e-2(a)(1) (1976). The question is whether differences in the periodic annuity payments to men and to women in otherwise comparable circumstances violate that prohibition, when the employer does nothing but arrange for the annuities with independent insurers using sex-segregated mortality tables. It cannot be discrimination in compensation, for no compensation is involved, but it is argued that it is discrimination against women in a *privilege* of employment.

Granted that there was a distinction made between men and women by the payment differential in the life annuity, the Court is faced with the question whether that was unlawful discrimination *against* women or as merely discrimination (a distinction) *between* men and women which is not forbidden by the statute. The preposition "against" is a crucial part of the statute. By using it the statute only forbids disadvantageous discrimination and not neutral discrimination.

Assume a promise is made to a person to pay D dollars per month until some event occurs which is certain to occur at some time but the precise time of which is unpredictable. This describes the traditional life annuity but it describes with equal accuracy an annuity for the length of time an automobile in some unrelated stranger's possession will continue to be roadworthy (by some prescribed test), or for the length of time a stallion can be used for stud purposes, or for the time until the foundations of a seaside house are undermined and it collapses (assuming no protective measures), and a multitude of other annuities. Assume further that it is possible from previous experience to state with acceptable accuracy the probability that the uncertain event will occur in each period in the future. This is analogous to a mortality table.

If one wishes to buy one of these promises what is the promise worth? The cost to the promisor is the sum of each monthly payment from now to eternity, discounted by the

probability that it will have to be paid and by the present value of a dollar paid at that future time. Thus it will be the sum of an infinite number of terms, each being the amount of the monthly payment times the probability that it will come due before the terminating event times the present value of 1 discounted from the date of payment to the present. Terms beyond a reasonable number of years will be infinitesimally small because of the double discount.

When the annuity is described in purely abstract terms, no one would question the above manner of computing the cost of the promise to the promisor. Its cost to the promisee is that cost plus a market-determined fee the promisor charges for handling the transaction. Irrelevant emotional issues such as the needs of retired persons do not confuse us in the abstractly stated case.

Value is thus determined by using a mortality table based on experience, as accurately recorded and interpreted as is possible (with mortality meaning only the duration of payment). If because of different characteristics there are different mortality tables for different classes of cars, stallions or houses, no one would think it amiss.

The development of appropriate mortality tables, or morbidity tables, or burning rates, or rates of automobile accidents of various degrees of severity, or industrial accidents, and so on, is the job of actuaries. Whatever the subject of the insurance or the annuity, two promises have equal value if they are actuarially equivalent, i.e., if the costs to the promisors are the same. (There may be a difference in the risk-bearing fee, based on differences in the variability of results and in characteristics of the respective markets, but that can be ignored for present purposes).

When one appreciates that the value of an annuity is measured not by the amount of each periodic payment but by the present value of their sum, one can appreciate why two persons who receive different periodic payments are being compensated equally. The best example in life annuities is where the ages are different. If two otherwise comparable people retire, one at 65 and one at 70, the two are being

treated equally when the 70-year old receives a larger annuity, even though the 70 year old person may live longer and get a substantially larger total sum. The payment is based on expectation of life, i.e., on the mortality table.

The case is no different for men and women, if proper actuarial tables are used. One can challenge the accuracy of the tables but not the principle of using them. Such a challenge is in effect an assertion that sex is only an imperfect surrogate for the true factors determining length of life, and that those true factors should *and can* be measured and the mortality tables be based on them instead of on sex. If that can be established, sex should then be abandoned as a criterion. But it has not been, and probably cannot be, established.

One can urge either the further refinement of actuarial tables in current use, or their total replacement, but the burden is heavy on one who would do so to show that the proposed new tables are justifiable actuarially. Though there is nothing sacrosanct about the present state of actuarial learning, it is not guesswork but is based on serious study. Replacement of accepted tables is not a casual matter.

The view that sex is an appropriate criterion for classification for rate-making in life insurance and annuities does not mean that there cannot be *unfair* sex discrimination. The traditional setback for women in life insurance has been three years, in annuities six. While the differential *may* be explicable and justifiable it needs to be justified. On the surface it looks like unfair discrimination against women in life insurance by not giving them a *sufficiently large* differential. Some life insurers have also thought so and have sought to exploit the opportunity for profit unfair discrimination always creates for other entrepreneurs. See Kimball, *Reverse Sex Discrimination: Manhart,* 1979 Amer. Bar Fnd'n. Res. J. 83, 136, fn. 137. Another possible case of sex discrimination is the use of proper tables, but the structuring of a plan where rights become vested only after a substantial period of time, and where female employees do not remain

long enough to get any vested rights while males do. Waitresses in a chain restaurant may provide an example.

VIII. SEX IS A VALID RATING CRITERION IN LIFE INSURANCE AND ANNUITIES.

The District Court in *Norris* v. *Arizona Governing Committee* objected to the use of sex as a rating criterion when "other factors affecting longevity, such as smoking habits, alcohol consumption, weight, prior medical history and family history are not specifically taken into consideration. . . ." 486 F. Supp. 645 (1980). To the extent that the gathering of the relevant information about these other factors can be done cost-effectively the criticism is a valid one. It does not lead to the elimination of sex as a criterion, however, but to the compulsory refinement of the classification system by factoring in the other information as well. That would reduce but not eliminate the dependence on sex. Whether this can be done cost-effectively for other factors than age and sex is a problem to which actuaries should give close attention, for the addition of several such factors would make the classification system more fair.

Smoking illustrates the complexity of the problem, however. While it is easy to classify persons by sex, there is no simple two-fold classification of smokers and non-smokers. First, relatively few persons have never smoked. Second, the measure of the effect of smoking on longevity depends on the ages at which a person has smoked, how much, whether smoking was associated with other pollution that in combination with smoking has a synergistic effect on the development of cancer or respiratory diseases, whether the smoker also has cardio-vascular disease, and so on ad infinitum. There is considerable question whether useful information about a person's smoking habits over a lifetime, together with the related exposures that interact with smoking, could be obtained cost-effectively with enough precision to be of any actuarial value.

Age and sex, the two primary criteria used currently in life insurance and annuity pricing, are both inexpensively

and precisely ascertainable. Other data are harder and more expensive to gather and may not be as helpful in predicting either mortality or morbidity. In the absence of full information, one seeking to base prices on costs must use what can be had so long as it has reasonable predictive value.

It is sometimes argued that causality and controllability are requisites of a valid classifier. The argument is that there is no proof that sex differences *cause* differences in mortality, and further that because one cannot choose one's sex it is unfair to penalize one born into the disfavored sex. Neither argument is valid. The actuary seeks to predict cost as accurately as possible in order to make a private business operate successfully. Cause can usually not be established and correlation must be relied on. Nor is cause important in determining price. Rate of incidence is. Further, any unfairness resulting from the uncontrollability of certain characteristics by the individual can best be corrected through taxation and governmental programs, not through distortion of private systems of risk transfer.

CONCLUSION

The action Arizona took after decision below in this case was not unpredictable. There had been no intention to commit state funds to this supplementary and voluntary savings plan. The order of the Court that the state supplement women's annuities quite naturally led Arizona to withdraw the life annuity, the retirement option that had produced the unwelcome result. That action, following the Court's decision, deprived all state employees of the opportunity to take advantage of the only option that would have given substantial protection against outliving sources of income and would also maximize tax benefits. The same withdrawal can be expected in many supplemental *and* basic contributory retirement programs, whenever offering the option subjects the employer to the risk (or the certainty) of having to provide additional funds to equalize women's annuity payments with those of men.

There is a possibility that many or all insurance companies interested in the retirement income market may shift to unisex mortality tables to counter the tendency of employers to withdraw the life annuity option. Then there will no longer be a financial incentive for the employer to limit options. Male employees will, however, acquire new incentives. One will be to press for additional options so they can avoid purchasing a life annuity that is (for them) overpriced. Well-advised males will then probably elect in large numbers the properly-priced annuity for a term certain, taking the chance that they will outlive their sources of income. That course is already attractive because the periodic payments would be larger. For them this would be a rational course, though it will exacerbate the social problem of poverty at extremely high age levels. An alternative is the withdrawal of the lump sum value of the savings to invest in an individual annuity in the open market based on a sex-segregated table. If American insurers were directly forbidden to use such tables, there remains the possibility of purchase from a Canadian or other alien company, unless tax consequences or other difficulties make that an unattractive course of action.

The cost of life annuities on a unisex basis to all participants will rise as more and more men withdraw from the scheme; eventually, if enough men withdraw, the cost will approximate what it would have cost women to buy annuities under a sex-segregated mortality table. They will be no better off than before but the men will be worse off by not being able to insure themselves properly against excessively long life through the cost-effective purchase of group annuities negotiated for by the employer. The advantages of a free market solution will have been lost.

These likely consequences of affirmance of the Court of Appeals for the Ninth Circuit are so dramatic and so substantial that they can be expected to revolutionize the insurance and pension industries. It is not believable that Congress would intentionally have enacted a law having such consequences, on the basis of a floor amendment, without

studies, without public hearings and with virtually no discussion or debate.

The belief that Congress cannot have intended to enact such a seriously disruptive law is supported by the fact that Congress long ago allocated to the states essentially full regulatory power over insurance, except in those instances where Congress itself makes clear that it is restricting the grant of power by wording its own statute to "specifically relate" to the business of insurance. This has been well known to Congress, which has seen many proposals to repeal or amend the McCarran-Ferguson Act. There is no language in the Equal Pay Act or in Title VII that specifically relates to the business of insurance. The Court below thought it was not regulating insurance with its order because the order went only to the employer. This is unrealistic, for the impact on the insurance companies, though indirect, is drastic and immediate. Thus, the order of the Court in this case *is* the regulation of insurance, contrary to the McCarran-Ferguson Act's intent.

The allocation to the states of regulatory power over insurance is not to be interpreted as immunizing insurance companies from contemporary public policy. The state legislatures and state insurance regulators are as much subject to the movements of contemporary opinion as is the Congress. Some states precede Congress in reacting; some states lag behind. Some state insurance regulators have been discussing problems of unfair discrimination in the pricing of insurance for much longer than the Congress has been discussing the matter and over a broader range of types of unfair discrimination. In recent years sex discrimination has been specifically discussed at considerable length in many individual states and in the National Association of Insurance Commissioners. The present posture generally is that unfair discrimination is avoided if pricing is accurately cost-based, i.e., if all distinctions used are justified actuarially.

Sex is actuarially justified as a valid predictor in life insurance and annuities. It could be improved upon by the addition of other variables (age is another variable that is

already used, of course), but the reliable measurement of still other variables at an affordable cost is a difficult problem in trying to provide a more refined price structure. Given that fact, the use of age and sex alone, without more variables, in the pricing of life insurance and annuities is justified, though far from the ideal or final solution. It surely will not be the end of actuarial development in rate-making, however. Some insurers are now experimenting with smoking as a variable in life insurance pricing. Kimball, *Reverse Sex Discrimination: Manhart*, 1979 Amer. Bar Fnd'n. Res. J. 83, 119, fn. 96. If it is a practicable variable to use, that experiment will succeed in the free market. If it does, eventually insurance regulators will consider it unfair discrimination to fail to use it as a criterion.

In any event, solving the difficult problem of fair pricing of insurance and annuities is not one the Congress undertook in its rough first attack on unfair sex discrimination in employment, for the solution of this knotty problem was allocated to the states by the McCarran-Ferguson Act. It is a task to which the states have devoted and will devote a good deal of attention. The preferable outcome in the case of *Arizona Governing Committee* v. *Norris* is reversal of the Court of Appeals and District Court decisions and dismissal of the complaint of plaintiff Nathalie Norris.

Respectfully submitted,

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